IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE: In Proceedings
Under Chapter 13

DONALD EWALD,
REGINA EWALD,

Case No. 02-40083

Debtor(s).

DONALD EWALD,
REGINA EWALD,

Plaintiff(s),

vs. Adversary No. 02-3079

CITIFINANCIAL SERVICES, INC.,

Defendant(s).

OPINION

In this case, the Court must address the issue of whether a creditor, who fails to object to a debtor's plan prior to confirmation, may subsequently challenge the validity of that plan on the basis that it impermissibly modifies a home mortgage in violation of § 1322(b)(2) of the Bankruptcy Code.

The facts in this case are not in dispute. On July 18, 2000, the debtors executed a trust deed in the nature of a second mortgage, granting Associates Finance, predecessor of defendant Citifinancial Services, Inc. ("defendant"), a security interest in their principal residence. No other collateral was given as security for this obligation.

On January 11, 2002, the debtors filed a petition under Chapter 13. In their schedules, the debtors listed Defendant as holding both first and second mortgages on their residential real estate,

While the debtors' Schedule D listed the first mortgage as partially secured, the second mortgage was listed as wholly unsecured.[1] In addition, the debtors' Chapter 13 plan classified the second mortgage as a general secured claim, rather than as a claim secured solely by residential real estate. Specifically, section III(G)(2) of the debtors' plan provides:

> (2) other claims secured by collateral ~~other than debtor's residential real estate~~ shall be paid the value of their collateral with the balance treated as an unsecured claim. These secured claims shall be paid with interest at the rate of 7.5% per annum. The debtor believes the following claims fall within this category:
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> | Creditor | Estimated Amount Claimed | Alleged Value of Collateral | Method of Valuation |
> |---|---|---|---|
> | Firstar Bank | $6,516.00 | $15,015.00 | NADA |
> | The Associates | $51,200.00 | $30,000.00 | NADA |
> | **Citifinancial** | **$15,068.00** | **$0** | **FMV** |

Debtors' Chapter 13 Plan, §III(G)(2)(emphasis added). While the defendant did file a secured claim in the amount of $15,067.90 on January 23, 2002, it did not object to the debtors' plan. Consequently, an order confirming the plan was entered on February 25, 2002.

On March 15, 2002, the debtors filed an adversary complaint objecting to the defendant's claim and seeking to invalidate its lien. The complaint alleges that because the value of the real estate securing the defendant's claims is insufficient to support even the first mortgage, the second mortgage should be allowed as a general unsecured claim. In response, defendant challenges not only the debtors' valuation of the

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[1]Debtors' Schedule D valued the real estate at $120,000. The first mortgage was valued at $125,800.00, leaving an unsecured balance of $5,800.00. As to the second mortgage, debtors valued the property securing that obligation at $0.

subject real estate, but also its treatment under the confirmed plan. Defendant contends that modification of its second mortgage by the confirmed plan was prohibited by § 1322(b)(2) of the Bankruptcy Code and, therefore, that the confirmed plan is invalid. Debtors have brought the instant Motion for Summary Judgment seeking to strike the defendant's argument under § 1322(b)(2) as an impermissible collateral attack on a confirmed plan.

DISCUSSION

The issue in this case involves the interaction between two provisions of the Bankruptcy Code, namely 11 U.S.C. § 1327 and § 1322(b)(2). The effect of confirmation of a Chapter 13 plan is set forth in 11 U.S.C. § 1327. Section 1327(a) states:

> (a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.

11 U.S.C. § 1327(a). Generally, this means that the failure to raise an "objection at the confirmation hearing or to appeal from the order of confirmation should . . . preclude attack on the plan or any provision therein as illegal in a subsequent proceeding." Matter of Chappell, 984 F.2d 775, 782 (7th Cir. 1993) quoting Matter of Gregory, 705 F.2d 1118, 1121 (9th Cir. 1983); see also In re Pence, 905 F.2d 1107, 1110 7th Cir. 1990). The purpose of § 1327(a), like that underlying the doctrine of *res judicata*, is to promote finality. As explained by the Seventh Circuit Court of Appeals in In re Harvey, 213 F.3d 318 (7th Cir. 2000),

> [t]he reason for this is simple and mirrors the general justification for *res judicata* principles -- after the affected parties have an opportunity to present their arguments and claims, it is cumbersome and inefficient to allow those same parties to revisit or recharacterize the identical problems in a subsequent proceeding.
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> This is especially true in the bankruptcy context, where a confirmed plan acts more or less like a court-approved contract or consent decree that binds both the debtor and all

> creditors. Bringing the various creditors' interests to the table once is difficult enough; permitting one of the creditors to launch a later attack on a confirmed plan would destroy the balance of interests created in the initial proceedings.

Id. at 321.

However, while a confirmed plan is generally *res judicata* as to all arguments that could have been raised prior to confirmation, the Seventh Circuit Court of Appeals has recognized an exception to the *res judicata* effect of a confirmed plan where the plan violates a mandatory provision of the Bankruptcy Code. In In re Escobedo., 28 F.3d 34 (7th Cir. 1994) , the Court dismissed a bankruptcy petition after completion of the confirmed plan on the grounds that it failed to provide for payment of priority tax claims owed to the Internal Revenue Service in violation of 11 U.S.C. § 1322(a)(2). In so holding, the Court explained that

> [m]andatory requirements such as § 1322 (a)(2), by definition, cannot be absent from a confirmable Chapter 13 plan. We conclude that [the plan at issue] was invalid for failing to include the mandatory provisions of §1322(a)(2) and has no *res judicata* effect as to the omitted priority claims.

Escobedo at 35 (citations omitted).

In the case at bar, the defendant, relying on Escobedo, argues that the debtors' confirmed plan is invalid because it fails to comply with the provisions of 11 U.S.C. § 1322(b)(2). That section states:

> (b) Subject to subsections (a) and (c) of this section, the plan may
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> (2) modify the rights of holders of secured claims, *other than a claim secured only by a security interest in the real property that is the debtor's principal residence,* or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

11 U.S.C. § 1322(b)(2) (emphasis added). By the express terms of this provision, a debtor may not restructure a home mortgage through their Chapter 13 plan.[2] The defendant maintains that this prohibition

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[2]Section 1322(b)(5) provides the only exception to this rule. That subsection permits a debtor to cure mortgage defaults over a reasonable period of time. See 11 U.S.C. § 1322(b)(5).

against modification of home mortgages is a mandatory Code provision, and, as the debtors' confirmed plan violates this section, said plan is nugatory.

The Court disagrees with defendant's reasoning for several reasons. First, Escobedo involved a violation of § 1322(a)(2), not § 1322(b). Section 1322(a) involves mandatory requirements and unequivocally sets forth the three requirements with which every plan must comply.[3] Section 1322(b), on the other hand, is couched in permissive or discretionary terms.[4] A discretionary term is one that "guarantees confirmation if a plan comports with the statutory provisions but does not mandate that the provisions be met in order for confirmation to occur." In re Szostek, 886 F.2d 1405, 1411 (3rd Cir. 1989). Congress could have included the prohibition against modification of home mortgages under the clearly mandatory provisions of § 1322(a), but did not do so.

The overall tenor of § 1322(b) is permissive in nature. In addition to prescribing the treatment for

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[3]Section 1322(a) states:

(a) The plan **shall**--

(1) provide for the submission of all or such part of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) provide for the fall payment, in deferred cash payments of claims entitled to fall priority under section 507 of this title, unless the holder of a particular claim agrees to different treatment of such claims; and

(3) if the plan classifies claims, provide the same treatment for each claim within a particular class.

11 U.S.C. § 1322(a) (emphasis added). See also Foster v. Heitkamp, 670 F.2d 478, 484 (5th Cir.1982).

[4]Section 1322(b), by contrast uses the language "may' rather than "shall" in defining the contents of the plan.

claims secured by an interest in the debtor's residential real estate, § 1322(b) lists ten provisions which a debtor is permitted to include in their Chapter 13 plan, but which they need not include in order for the plan to be confirmed. For instance, not only does § 1322(b)(2) address creditors secured by a security interest in real estate that is the debtor's principal residence, but it is also applicable to creditors secured by non-residential real estate, creditors secured by non-real estate collateral, and unsecured creditors. With exception of the narrow limitation which creates a right in favor of creditors holding interests in residential real estate that is the debtor's principal residence, all of the provisions of § 1322(b) are permissive. See Escobedo at 35, ftn 1; In re Harvey, 213 F.3d 318, 322-23 (7th Cir. 2000) (The Seventh Circuit expressly states that the provisions of § 1322(b) are permissive rather than mandatory in nature).

The language in question is a limitation or an exception on a permissive right. A debtor may opt to include a provision in their plan modifying the rights of secured creditors under § 1322(b)(2), subject to the limitations of the "anti-modification" clause, but is not required to. The "antimodification" is only triggered if the debtor's plan attempts to modify the rights of a residential mortgage holder. However, in order to preserve the rights afforded them under this section, the holder of the security interest must object to its treatment under the plan.

Construing § 1322(b) and, in particular, § 1322(b)(2) in this fashion does not destroy a right given to a creditor by Congress. All it does is require creditors to monitor cases and protect their interests by objecting to confirmation, something that this creditor did not do. In so concluding, this Court is in no way attempting to disregard the special treatment bestowed on mortgage lenders through § 1322(b)(2). The court must also consider the importance of protecting the finality of a confirmation order. While this approach creates the possibility that mortgage lenders such as the defendant may lose important rights due to their own inaction, "if a confirmed plan [can] be routinely upset by late-filed objections to claim

treatment, Chapter 13 [will] certainly become a toothless tiger." In the Matter of Walk , 128 B.R. 465 (Bankr. D. Idaho 1991).

In the case at bar, defendant received a copy of the debtors' plan prior to confirmation and, despite having notice that the debtors' intended to treat the second mortgage as a wholly unsecured claim, the defendant did nothing.[5] As the Seventh Circuit noted in Harvey:

> "Forcing parties to raise concerns about the meaning of Chapter 13 filings at the original confirmation proceedings does not impose an unreasonable burden on bankruptcy participants. Quite the contrary- it is perfectly reasonable to expect interested creditors to review the terms of the proposed plan and object if the terms are unacceptable, vague, or ambiguous. As this Court said in *In re Pence*, 905, F.2d 1107, 1109 a creditor is 'not entitled to stick its head in the sand and pretend it would not lose any rights by not participating in the proceedings.'

In re Harvey, 213 F.3d 3l8 (7th Cir.2000). While the plan's failure to comply with § 1322(b)(2) in this case would have been a valid objection prior to confirmation of the plan, it is not a legitimate basis for challenging the plan post-confirmation. Therefore, the defendant is bound to the terms of the confirmed plan pursuant to 11 U.S.C. § 1327(a).

For the reasons stated, the plaintiffs Motion for Partial Summary Judgment is granted and defendant's affirmative defense regarding 11 U.S.C. § 1322(b)(2) is stricken.

ENTERED: September 26, 2002

/s/ William V. Altenberger
United States Bankruptcy Judge

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[5]Not only did the defendant fail to object to its treatment under the plan prior to confirmation, it also did not move to set aside the confirmation order.